BUSINESSEUROPE

PRESS BRIEF

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Visit to ECB on 4 April 2007

BUSINESSEUROPE delegation

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Main messages

Economic recovery on a firmer footing …

- The EU economy continues to send strong signals. The upturn in Germany is particularly encouraging, with strong exports, investment and now employment growth. The impact of the 3% VAT hike in January this year is still uncertain, but labour market improvements should help alleviate the impact on consumer spending.
- At EU level, employment is currently the most positive element in the recovery. We expect 8.5 million new jobs in the EU over the period 2006 to 2008, against an increase in the active-age population by a mere 1.7 million people. Declining unemployment and rising participation shows the benefits of past reforms aimed at reintegrating people in the labour market and of wage moderation.
- However, not all signs have turn to green: productivity growth remains weak in this recovery (1.5% over expected over the next two years), and is largely insufficient to sustain EU's generous welfare systems in an ageing society.
- Internal imbalances also continue to grow within the euro area. The large competitiveness gap of Italy, Spain, Greece, Portugal or France with respect to Germany will probably rise further over the next few years.
- There are also important risks related to the global economic situation: exchange rate developments, prospects in the US, and renewed tensions on oil prices.

BUSINESSEUROPE backs the ECB, and defends its policy record

- The benefits of monetary union are indisputable. We consider that the ECB's strong institutional independence and clear mandate has been a significant contribution to this success. The ECB's credibility is reflected in the combination of low market interest rates and low inflation: the two yardsticks of a successful central bank.

- We are against any change in its status or mandate of the ECB and are rather concerned by the debate on the euro currently under way in France.
- Regarding the current monetary policy stance, interest rates are now at 3.75% (after 7 hikes since dec. 2005), close to neutral levels for the recovery. At this stage, we think that there are no obvious reasons to go much further, unless clearer signs of inflationary pressures are building up.
- The ECB currently points to two main risks: strong credit growth and wage developments. On credit and monetary aggregates, we tend to trust the ECB's judgment.

Euro appreciation has to be a baseline assumption for policy makers…

- Recent exchange rate developments do not yet place a question mark over the recovery in Europe. A relatively strong euro can even bring positive elements in the upturn, such as reduced input costs for companies, lower inflationary pressures in general and more incentives to reform.
- However, this should not lead to a benign neglect of currency risks. The size of the US current account deficit, which reached 857 billion dollars in 2006, leaves little doubt that we will live in a weak dollar environment in coming years.
- The big uncertainty at present is whether the currency of regions with large current account surpluses, such as China and Asia in general, will shoulder an appropriate share of this dollar weakness, or if this burden will fall disproportionately on European currencies.
- Recent exchange rate developments are not particularly encouraging, with the Japanese yen at historical low levels and only slow revaluation of the Chinese yuan against the dollar.
- European policy-makers need to push for a decoupling of major global currencies with the dollar.

Competitiveness imbalances: a national but also a euro area issue…

- Global imbalances and exchange rate risks also create a sense of urgency to tackle internal imbalances within monetary union.
- Spain, Italy, Portugal, Greece or France have since the start of monetary union seen their external competitiveness drift by around 15% to 25% against Germany (as measured by relative unit labour costs). Today, among the five OECD countries with the largest current account deficits, three are in the euro area – Spain, Portugal and Greece – mainly compensated by large surpluses in Germany, the Netherlands or Finland.
- This is a source of concern for individual countries but it also matters for the functioning of monetary union. Reform surveillance needs to be strengthened for euro-area countries, either within the current institutional framework or via a reinforced role of the eurogroup.

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Stability and Growth Pact: "good times" should mean more consolidation…

- Revisions to the Stability and Growth Pact in 2005 were not so well received by the business community. BUSINESSEUROPE feared a "pacte à la carte" where "exceptional circumstances" could justify bad performers running deficits in excess of 3% of GDP.
- But there were also positive changes: greater account of debt level and debt sustainability, more focus on consolidation during good times.
- In practice, the negative expectations have not materialised. Deficits in excess of 3% are becoming very rare these days and this could partly be credited to a renewed ownership and credibility of excessive deficit procedures.
- The real test for the new Stability and Growth Pact is in front of us, and will be to impose fast progress towards sustainable public finances in the current recovery.
- Looking at current Stability Programmes, consolidation plans for the next two years are more ambitious than in the past, but they remain excessively focused on tax increases and they fall short of the structural adjustments required by the new rules of the Stability and Growth Pact (more than 0.5% of GDP in good times).
- Beyond deficit and debt concerns, the quality of public finances is also crucial. In coherence with the Growth and Jobs strategy, resources must be directed in priority towards growth-enhancing spending such as education, training, research, innovation and infrastructures.
- Finally, efforts to reform pension and health care systems will need to be stepped up before ageing pressures actually start biting.